Navigating the K-shaped transition in China

Standard Chartered · Oli Fernandes · 2026-09-03 · English original

China is undergoing a K-shaped transition amid mixed macro trends, but a discerning investment approach reveals opportunities across equities and fixed income.

Raymond Cheng Chief Investment Officer, North Asia

China's financial markets stand at a pivotal crossroads. As we enter the final stretch of 2026, onshore equities have reversed course, erasing gains from the start of the year. Recent economic prints have also surprised to the downside, fuelling scepticism among global investors. This headline weakness, however, hides a structural K-shaped transition beneath the surface, where the advanced technology and new-economy sectors thrive while traditional industries struggle.

At the index level, stock market performance reflects broader regional dynamics. On the surface, onshore equities have had little to cheer about of late. The CSI 300 Index has pulled back, giving up the 10% rally seen in the first half of the year. Importantly, China was not alone in the sharp correction that swept through global AI, momentum, and higher-beta (more volatile) stocks in July. As the CSI 300 struggled, the MSCI Taiwan Index dipped by a similar margin, and the MSCI Korea Index tumbled over 30%. Conversely, the Hang Seng Index rallied over 13%, and Southeast Asian markets rose 8% in the month.

Far from pointing to a broader collapse, observations from a recent trip to Shanghai have in fact strengthened my conviction in China within our preferred Asia ex-Japan (AxJ) region. While China's near-term macro outlook is mixed, a discerning, on-the-ground approach reveals a market with investment opportunities across asset classes.

The power of diversification

The performance divergence across AxJ markets is a testament to the power of geographic and sectoral diversification. Our Overweight recommendation on AxJ equities has been vindicated by this volatility. Our positive stance on China offshore equities has effectively offset the pullback in tech stocks elsewhere in the region. As we moved into August, AxJ bounced back to return over 3% in one month, cementing its status as one of the two outperforming regions globally, alongside the US.

We often face questions about our equity allocation to China, given the broad-based weakness in July macro prints ranging from retail sales to industrial production. It is true that China is navigating a K-shaped economic transition. AI and high-end industrials are booming, while traditional industries face excess capacity and muted domestic demand.

Despite widespread concerns over weak consumption driven by job insecurity and income instability, our observations on the ground tell a different story. Record-high summer movie theatre admissions and the staggering markups young mainlanders are paying for live concert tickets on the black market suggest that the Chinese consumer is not absent. They are merely selective, pivoting away from luxury brands and big-ticket upgrades towards experiences and emotional spending.

Investment implications of the K-shaped transition

The selective behaviour seen among Chinese consumers informs our investment strategy. Listed AI equities remain underrepresented in China's equity indices, which are still dominated by traditional, cyclical industries. Without a broad-based economic recovery, it is difficult to foresee a notable rally in the broad China indices. Since July, technology stocks in both onshore and offshore China markets have pulled back notably, while US peers have recovered lost ground on strong earnings.

We view this pullback as a unique entry point. We recommend exposure to China's AI ecosystem, as well as power and electrification – two themes that enjoy incremental policy support. Following the July Politburo meeting, the National Development and Reform Commission (NDRC) announced a CNY 4 trillion five-year investment in the national computing network. This is not merely reflective of China's self-sufficiency initiative; it is a response to soaring demand, evidenced by the rising average daily AI token call volume. The NDRC is working to pool AI computing infrastructure to reduce bottlenecks and ensure seamless nationwide computing power supply.

Furthermore, funding is materialising. Apart from increased government bond issuance, two high-profile Chinese corporates – an iconic robot maker and the world's fourth-largest DRAM chipmaker – received the greenlight for A-share IPOs this summer. Both have seen their prices surge multiple fold since listing, signalling that China's capital markets are supporting the new economy.

Beyond equities

Investment opportunities in China extend beyond the stock market. China Government Bonds (CGBs) are effective portfolio diversifiers, offering returns uncorrelated to the developed markets plagued by inflationary pressures and rising yields. We see room for a downtick along the longer end of the CGB yield curve, with additional price return potential coming from anticipated USD weakness.

Building diversified cross-asset China exposure

As China's economic outlook remains challenged by sectoral divergence, we recommend a selective approach to growth equities, focusing on AI, high-end industrials and electrification, balanced with quality dividend equities as well as CGBs. In a complex, evolving global landscape, it is crucial to navigate China with diversified exposures aligned with policy support and quality attributes.

Source: https://www.sc.com/en/news/wealth-retail-banking/navigating-the-k-shaped-transition-in-china/